

SUMMARY ANALYSIS OF AMENDED BILL

Author: Machado Analyst: Colin Stevens Bill Number: AB 2221

Related Bills: _____ Telephone: 845-3036 Amended Date: 4/23/98

Attorney: Doug Bramhall

Sponsor: _____

SUBJECT: Internet Service Provider Tiering, Filtering System, Gateway Scanning Device Credit

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended MARCH 30, 1998.
- ☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- ☐ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- ☒ FURTHER AMENDMENTS NECESSARY.
- ☐ DEPARTMENT POSITION CHANGED TO _____.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED MARCH 30, 1998, STILL APPLIES.
- ☐ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and Bank and the Corporation Tax Law (B&CTL), this bill would allow a credit to taxpayers who are qualified Internet service providers (ISPs). The credit would be equal to the total cost paid or incurred by the taxpayer for the purchase and installation of a tiering or filtering system, or a gateway scanning device, as defined, that is placed on the ISP's web server, but could not exceed \$50,000 per taxpayer per year.

SUMMARY OF AMENDMENT

The April 23, 1998, amendments would:

- Limit the credit to \$50,000 per taxpayer per year;
- Require that a qualifying tiering or filtering system be placed on a web server located in California;
- Require that at least 51% of a qualified Internet service provider's clients reside in or do business in California;
- Clarify that any unused credit could be carried forward for up to eight years;
- Provide a repeal date of December 1, 2003, and specify that this bill would not apply to taxable or income years beginning on or after January 1, 2003; and
- Require the Legislative Analyst's office to report to the Legislature by January 1, 2002, on this credit.

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

☐ S ☐ O
☐ SA ☐ OUA
☐ N ☐ NP
☐ NA ☐ NAR
☒ X PENDING

Agency Secretary Position:

☐ S ☐ O
☐ SA ☐ OUA
☐ N ☐ NP
☐ NA ☐ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved _____
Position Disapproved _____
Position Noted _____

Department/Legislative Director Date
Johnnie Lou Rosas **4/27/98**

Agency Secretary Date

By: _____ Date: _____

Except for the changes discussed above, the new revenue analysis, the resolution of certain policy and technical considerations identified in the department's prior analysis of the bill as amended March 30, 1998, the remainder of the department's analysis of the bill still applies. The considerations that still apply are reiterated below.

Policy Considerations

This bill would allow a credit equal to 100% of identified costs for taxpayers who purchase and install tiering or filtering software but would limit the allowable credit amount to \$50,000. A 100% credit is unprecedented as a matter of state tax policy.

Implementation Considerations

Further clarification of the types of expenditures that would qualify as "hardware" and of the definition for a "server" would help to ensure that disputes do not arise between taxpayers claiming the credit and the department as to who can claim the credit and qualifying expenditures.

FISCAL IMPACT

Tax Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows in applied credits:

Estimated Revenue Impact AB 2221		
Effective for Income Years Beginning on or After 1/1/98		
Enactment Assumed After June 30, 1998		
Fiscal Year Impact		
(In Millions)		
1998-9	1999-0	2000-01
(\$0.5)	(\$1)	(\$2)

This estimate does not account for any changes in employment, personal income, or gross state product that might result from this proposal.

Tax Revenue Discussion

Revenue losses under this bill would depend on the number of ISPs (Internet Service Providers) that purchase and install a tiering or filtering system, or a gateway scanning device, the cost of that system and the ability of the ISP to apply credits generated.

According to industry sources, costs for a tiering or filtering system or a gateway scanning device can vary significantly depending on the number of users, and the type and degree of filtering offered. These costs can range from \$3,000 to as much as \$1 million or more. However, as a practical matter it is not anticipated that the average ISP would expend a million dollars for such systems. For the most part it is estimated that many of the larger ISPs, primarily national ISPs, would develop much of their own software.

According to the same sources there are approximately 500 ISPs located in California. Revenue estimates above assume 10% of existing ISPs would qualify annually for the credit for an average cost for hardware and software of \$50,000. In addition, the impact assumes that new business entities specifically formed to provide filtering access service to the Internet would match qualifying expenses of existing ISPs. To allow for available tax liabilities and the tentative minimum tax interaction, it was assumed that 60% of credits generated would be used over a period of three years.

Finally adjustments were made to account for the offsetting tax effect of deductions that would be otherwise allowed under current law.